STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

COMMONWEALTH EDISON COMPANY	:	
	:	
Petition to implement a competitive procurement process by establishing Rider CPP, Rider PPO-MVM, Rider TS-CPP and revising Rider PPO-MI	:	**Docket No. 05-0159**
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	:	

INITIAL BRIEF

OF

THE BUILDING OWNERS AND MANAGERS ASSOCIATION OF CHICAGO

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* NOTE: This Table of Contents includes only the sections and subsections from the Issues Outline for this case which are addressed in this Initial Brief of the Building Owners and Managers Association of Chicago.

Now comes the BUILDING OWNERS AND MANAGERS ASSOCIATION OF CHICAGO ("BOMA"), by its attorneys GIORDANO & NEILAN, LTD., and hereby files its Initial Brief in this proceeding pursuant to Section 200.800 of the Rules of Practice of the Illinois Commerce Commission (the "Commission" or "ICC").

I. EXECUTIVE SUMMARY

Commonwealth Edison Company ("ComEd") proposes to use an auction process to procure its entire requirements for electricity supply beginning January 1, 2007. ComEd's auction uses a "descending clock" uniform price approach, meaning that ComEd would pay all winning suppliers the same price. Under ComEd's auction proposal, bidders would first be asked to supply power at a relatively high price at which an oversupply of power would be expected to be bid. The auction price would then "tick down" until the amount of supply offered no longer exceeded ComEd's full electricity supply requirements. At that point, the auction would be stopped and all remaining bidders would be paid the uniform "market clearing" price at which the auction was ended.

Under ComEd's proposal, post-2006 charges to consumers would be based on the pass-through of ComEd's costs of electricity supply resulting from the auction in addition to ComEd's charges for delivery of electricity. ComEd has separately requested that the Commission approve a substantial increase in its delivery charges.

The uniform, "market clearing" price auction format proposed by ComEd violates the Public Utilities Act because it is not the least-cost method of electricity supply procurement. In order to remedy this problem, BOMA witness Dr. Arthur B. Laffer, an economist of international renown, has proposed ComEd's proposed auction be modified from a descending clock, uniform price auction to a descending clock, pay as bid approach. Under Dr. Laffer's descending clock, pay as bid approach the auction would not stop when it reaches a “market clearing” price. Under Dr. Laffer’s pay as bid method, in contrast to ComEd’s approach, bidders would not be informed when the amount of supply being bid no longer exceeded ComEd’s electricity supply requirements. As a result, bidders who want to insure that they are successful in the auction will continue to bid until they are no longer satisfied with their profit margins.

A chart showing the elements of Dr. Laffer’s descending clock, pay as bid auction which differ from ComEd’s descending clock, uniform price auction is attached as Attachment A to the Initial Brief. As Dr. Laffer fully explained in written and oral testimony in this case, his approach will in all likelihood result in a lower cost of supply for ComEd and therefore lower charges for consumers. As Dr. Laffer also pointed out in both his written and oral testimony, ComEd’s uniform price approach not only will harm consumers but also will unfairly benefit ComEd’s affiliate, Exelon Generation, which will be a bidder in ComEd’s auction. Therefore, BOMA urges the Commission to modify ComEd’s proposed auction so that it incorporates Dr. Laffer’s proposed pay as bid approach rather than ComEd’s proposed uniform, “market clearing” price method.

If the Commission adopts Dr. Laffer’s pay as bid approach in its final order in this case, ComEd will implement this approach according to the unambiguous testimony of ComEd President Frank Clark in response to questions by BOMA counsel:

> Q. But I am asking you if the Commission made the determination that Dr. Laffer's approach would result in a lower auction price, would ComEd implement that approach?
>
> A. ComEd will implement any process that the Illinois Commerce Commission determines to be the appropriate process to procure power.
>
> Q. So the answer is yes to my question, correct?

A. The answer is yes.

(ComEd Tr., pg. 140, ln. 9 to pg. 141, ln. 6).

BOMA also requests that the Commission reject ComEd's proposal to replace its current PPO tariff, Rider PPO-MI, with its proposed Rider PPO-MVM. ComEd's PPO-MVM is not a valid PPO tariff under Section 16-112(a) of the Public Utilities Act because its "market value" charges for electricity supply are not determined as a function of an exchange traded or other market traded index, options or futures contract or contracts applicable to the market in which the utility sells, and the customers in its service area buy, electric power and energy.

In addition to proposing the elimination of its current PPO tariff, ComEd also has proposed the elimination of all of its current "bundled rates" for electricity supply and delivery. Elimination of the current bundled rates will have a particularly negative effect on nonresidential consumers which use electricity for space heating. Therefore, BOMA also requests that the Commission not approve ComEd's tariffs in this case unless ComEd includes an exemption from demand charges for electricity used by nonresidential space heating customers in its delivery service tariffs. Otherwise, as BOMA witnesses Mr. Brookover and Mr. Childress testified in this proceeding, nonresidential space heating customers will suffer severe rate shock ranging from an estimated 27.2% at a 5 cents per kWh auction price to 46.5% at a 6 cents per kWh auction price.

Finally, BOMA requests certain other changes to ComEd's proposed tariffs which will result in less volatility in ComEd's charges to consumers. All of BOMA recommended changes to ComEd's proposal are set forth in a chart attached as Attachment B to this Initial Brief.

V. AUCTION DESIGN ISSUES

C. MULTIPLE ROUND DESCENDING CLOCK FORMAT

4. Bid Decrements

Please see the discussion of this issue on page 5 in Section V.D.1 of this Initial Brief.

D. CLEARING PRICE: UNIFORM VS. PAY AS BID

1. BOMA Witness Dr. Arthur Laffer has Proposed That ComEd's Proposed Descending Clock Auction be Modified From a Uniform Price Approach to a Pay as Bid Method

BOMA witness Dr. Arthur B. Laffer has recommended that ComEd's proposed auction procurement process be changed from a descending clock, uniform price format to a descending clock, pay as bid approach. (BOMA Ex. 1.0, pg. 11, ll. 246-248). Dr. Laffer's recommended pay as bid modification to ComEd's proposed auction was fully described and supported in Dr. Laffer's written and oral testimony. The record evidence establishes that in all likelihood Dr. Laffer's proposed pay as bid approach will result in ComEd paying a lower price for its electricity supply than ComEd's proposed uniform price method. (BOMA Ex. 1.0, pp. 6-7, ll. 134-137, pp. 10-11, ll. 234-242, pg. 11, ll. 246-258, pp. 12-13, ll. 274-287; BOMA Ex. 3.0, pg. 4, ll. 69-76; ComEd Tr., pg. 381, ln. 13 to pg. 382, ln. 21; pg. 389, ln. 5 to pg. 390, ln. 13; pg. 392, ln. 8 to pg. 313, ln. 19; pg. 394, ln. 5-19; pg. 398, ln. to pg. 399, ln. 9).

The essential features of Dr. Laffer's proposed descending clock, pay as bid auction are the following:

- Instead of stopping the auction as ComEd proposes when the amount of electricity supply offered by bidders equals ComEd's full electricity supply requirements, prices continue to tick down lower until there remains no bidder willing to supply electricity at a lower price. (BOMA Ex. 1.0, pg. 11, ll. 249-252).
- Bidders would not be informed when the amount of electricity supply being bid equaled ComEd's full requirements. (ComEd Tr., pg. 392, ln. 19 to pg. 393, ln. 10).
- Bidders would not be provided with round-to-round information on excess supply remaining in the auction, as ComEd has proposed in its approach, in order to avoid

implicit collusion among bidders on when they should stop bidding. (BOMA Ex. 1.0, pp. 13-15, ll. 302-334; BOMA Ex. 3.0, pg. 5, ll. 94-104)

- To further avoid facilitating implicit collusion among bidders, the tick-down in price from round to round would be made in equal decrements rather than being based on the excess supply remaining in the auction as ComEd has proposed. (BOMA Ex. 3.0, pg. 6, ll. 126-136).

When Dr. Laffer's proposed descending clock, pay as bid auction is completed, bids would be accepted in ascending order of price until ComEd's full requirements are filled. (BOMA Ex. 1.0, pg. 1, ll. 17-22; pg. 11, ll. 254-256; BOMA Ex. 3.0, pg. 7, ll. 146-154). Each bid accepted would be at the lowest price at which the bidder was willing to sell electricity to ComEd. (BOMA Ex. 1.0, pg. 11, ll. 250 to 256). An example of how the auction would work was presented by Dr. Laffer as BOMA Exhibit 3.1 and is attached to this Initial Brief as Attachment C.

In stark contrast to Dr. Laffer's approach, ComEd's proposed uniform price auction stops at the "market clearing" price at which the quantity of electricity that suppliers are willing to supply meets ComEd's full electricity requirements. (ComEd Ex. 4.0, pg. 27, ll. 639-640, pg. 43, ll. 997-998, pg. 45, ll. 1044-1045; ComEd Ex. 19.3, pg. 8). When this market clearing price is reached, the bidders remaining in the auction all receive this price.[1] (ComEd Ex. 8.0, pg. 4, ll. 81-84; ComEd Ex. 11.0, pg. 65, ll. 1522-1525; ComEd Ex. 19.3, pp. 45-46). As the Commission Staff pointed out in its Final Report to the Commission on the Post-2006 Initiative ("Post-2006 Report"), under ComEd's approach "the auction price may reflect the higher costs of the less

[1] If the amount of electricity supply offered by bidders in the last round in ComEd's uniform price approach is less than ComEd's full requirements, then the price reverts back to an even higher priced prior round (the "exit price") and all bids are accepted to meet ComEd's requirements at the "exit price." (BOMA Ex. 1.0, pg. 6, ll. 123-128).

efficient generators bidding in the market." (ComEd Ex. 1.2, Post 2006 Staff Report, pg. 11). In other words, as we further discuss below, ComEd's affiliate Exelon Generation will be paid the same uniform, market clearing price as bidders with much higher production costs under ComEd's proposed auction structure. This phenomenon is avoided in Dr. Laffer's pay as bid method because Exelon Generation and other bidders which can produce low cost electricity will need to bid a price lower than the "market clearing" price in order to insure their success in Dr. Laffer's proposed pay as bid auction because they will not know when the "market clearing" price is reached. This approach will result in the most competitive auction possible and therefore the lowest possible market-determined ComEd charges to consumers.

2. Dr. Laffer's Pay as Bid Approach is Correct in Allowing Bidders to Continue to Bid Until They are no Longer Willing to Bid a Lower Price Rather Than Stopping the Auction at a Uniform, Market Clearing Price

Dr. Laffer succinctly summarized the fundamental flaw in ComEd's proposed uniform price auction in his rebuttal testimony: "Why on earth would anyone ever prohibit a supplier from offering a lower price?" (BOMA Ex. 3.0, pg. 4, ll. 83-84). Dr. Laffer testified that the ComEd approach violates basic economics because it does not utilize the entire supply curve. (BOMA Ex. 1.0, pp. 12-13, ll. 279-287; BOMA Ex. 3.0, pg. 12, ll. 279-283). Dr. Laffer elaborated on this point in response to a question posed by Administrative Law Judge ("ALJ") Wallace:

> Q All right. In light of that, why do you still insist that your method is better? Simply because of the potential for collusion?
>
> A Well, that's one of the things there, but it's general economics, sir. This is a general economic situation whereby I do not understand how you can make it better for the people of Illinois not to allow a supplier to offer a lower price.

> Why you would say you cannot go below this price makes no sense whatsoever to me or basic economic textbooks. You should always allow them to bid lower if they want to.

(ComEd Tr., pg. 412, ln. 18 to pg. 413, ln. 7).

Dr. Laffer also testified that ComEd's prohibition on suppliers bidding lower in a descending clock auction makes sense only in the context of ComEd's affiliate relationship with electricity supplier Exelon Generation, which owns more than 10,000 megawatts of nuclear generating capacity located in ComEd's service territory. (ComEd Tr., pg. 398, ll. 6-12; CUB-CCSAO Ex. 1.2). Dr. Laffer also discussed this issue further in another discourse with ALJ Wallace:

> Q ComEd disagrees that they are monopsonist. Easy for you to say.
>
> A I don't know if they disagree with that or not, but ComEd is the single buyer in this specific market. And that's what sort of monopsonist means.
>
> The strange thing about ComEd in this market is they also are a sister corporation of one the generators who's supplying this market and in the auction selling to ComEd.
>
> Exelon Generation and ComEd, of course, are owned by Exelon Corporation together. So it would be very surprising to me if ComEd did not have an interest in seeing Exelon Generation do well because it would help the other company.

(ComEd Tr., pg. 411, ln. 17 to pg. 412, ln. 8).

Dr. Laffer first pointed out ComEd's serious conflict of interest due to its affiliation with Exelon Generation in his direct testimony. (BOMA Ex. 1.0, pp. 15-16, ll. 340-368). Although ComEd's prohibition on bidders bidding lower helps Exelon Generation, it is diametrically opposed to the interests of ComEd's consumers. As ComEd President and Exelon Corp. Chief of Staff Frank Clark testified under cross-examination by BOMA counsel, he has a responsibility for designing and implementing policies that are designed to maximize returns to Exelon shareholders to the greatest extent possible. (ComEd Tr., pg. 136, ln. 19 to pg. 137, ln. 6). ComEd's conflict of interest will motivate it to oppose any electricity supply procurement process that results in lower payments to electricity suppliers because such a process is in conflict with the interests of Exelon Corp.'s subsidiary Exelon Generation.

Perhaps most importantly, Dr. Laffer's proposal not only will provide bidders the opportunity but also the incentive to bid lower than under ComEd's proposed uniform price approach, as Dr. Laffer explained in response to further questions by ALJ Wallace:

> Q Okay. And if you come down from 30 to 29, how do [you] lose volume?
>
> A If they bid at 29, that's fine. But let's say they withdraw their bid. Let's say at 30 they say, We're not going to bid any more, and it comes down to 29 and the auction filled and they've lost the market.
>
> And they then aren't supplying to that market at 29 because they made a mistake and thought the market was cleared at 30. They don't know what the market clearing price is unless someone tells them.
>
> And if no one tells them, they will continue to bid the price that they think is still profitable for them.
>
> Q So if their costs are 25, they will keep going down?
>
> A Yeah. They'll keep going down until they balance off the risk and the return of going further, of course.
>
> Q Because they want the --
>
> A They want the market. That's exactly right. I mean, that's what you do in any type of negotiation.
>
> When you build a rec room in your house, you go to people and ask them to bid and you use the pay-as-bid approach. You don't market clear at the highest person who says he'll build your rec room.
>
> Q Unless it's your brother-in-law.

A Couldn't have said it better, exactly.

(ComEd Tr., pg. 414, ln. 14 to pg. 415, ln. 21).

Of course, ComEd could not rebut the conflict issue. Instead, ComEd contended through their witnesses that their uniform, "market clearing" price approach might result in a lower supply price than Dr. Laffer's pay as bid approach because bidders have the incentive to bid low prices in a market clearing price auction since all bidders know they will receive the market clearing price regardless of how low they bid. (ComEd Ex. 11.0, pg. 68, ll. 1595-1600; Joint Tr., pg. 897, ln. 19 to pg. 898, ln. 2). Although this theory could apply to market clearing price auctions that do not use a descending clock structure which starts with a high price and clicks down, Dr. Laffer pointed out that this approach does not apply here because bidders will never have a chance to bid low under the descending clock structure. (Rev. ComEd. Ex. 11.0, pp. 67-68, ll. 1579-1605; BOMA Ex. 3.0, pg. 8, ll. 168-172; ComEd Tr., pg. 389, ll. 9-16; pg. 294, ll. 16-18). In a descending clock structure, Dr. Laffer clearly is correct that bidders should be allowed to bid as low as they desire in an effort to be successful in the auction.

3. Dr. Laffer's Approach Will Provide Sufficient Electricity Supply to ComEd

Following extensive ComEd testimony regarding Dr. Laffer's pay as bid proposal, ComEd's auction designer Dr. Chantale LaCasse testified on redirect examination that she saw two remaining concerns regarding Dr. Laffer's proposed recommendations. (Joint Tr., pg. 968, ll. 5-6). The first of Dr. LaCasse's concerns was that there might not be enough suppliers for a given product (i.e., 1-yr., 3-yr., or 5-yr. supply contracts) in the auction. (Joint Tr., pg. 968, ll. 14-16; pg. 978, ln. 20 to pg. 979, ln. 7). Despite her stated concern about adequate supply in her redirect examination, Dr. LaCasse admitted under recross examination by BOMA counsel that there will be a lot of interest in the 1-year, 3-year and 5-year products, respectively. The specific exchange between Dr. LaCasse and BOMA counsel was as follows:

> Q. Right, but there is likely to be interest in the five-year product, isn't there?
> A. Yes.
> Q. And there is likely to be interest in, a lot of interest, in the five-year product, correct?
> A. Yes.
> Q. And there is likely to be a lot of interest in the three-year product, correct?
> A. Yes.
> Q. And there is likely to be a lot of interest in the one-year product, correct?
> A. Yes.

(Joint Tr., pg. 981, ll. 6-17).

Adequate supply for ComEd auction products under Dr. Laffer's proposed pay as bid approach is not a real issue. The auction process will be the only opportunity to obtain long-term supply contracts with ComEd. (BOMA Ex. 3.0, pg. 11, ll. 244-252). In ComEd's service territory, the amount of generating capacity greatly exceeds the peak electricity demand (i.e., there is substantial excess generating capacity). (Joint Tr., pg. 704, ll. 6-18; CUB-CCSAO Ex. 1.2). Moreover, as ComEd consistently pointed out throughout this case, electricity supply from generating capacity anywhere in the very large PJM regional transmission organization can be bid into the auction. (ComEd Ex. 5.0, pg. 1, ll. 19-21; ComEd Ex. 9.0, pg. 18, ll. 405-410; ComEd Ex. 14.0, pg. 9, ll. 185-188; ComEd Ex. 15.0, pg. 10, ll. 186-193). Clearly, Dr. LaCasse's premise that adoption of Dr. Laffer's pay as bid method could somehow result in a lack of sufficient supply for particular products is untenable.

4. Dr. Laffer's Pay as Bid Approach is Correct in Not Providing Information to Bidders on the Amount of Excess Supply Being Bid into the Auction

The second remaining concern with Dr. Laffer's proposal expressed by ComEd's auction designer Dr. LaCasse was that Dr. Laffer's approach would not get the "best bids" because under his approach information regarding the amount of excess supply being bid into the auction would not be revealed to the bidders. (Joint Tr., pg. 981, ln. 18 to pg. 982, ln. 6). ComEd's witnesses have testified throughout this proceeding that the purpose of providing bidders with round-by-round information on excess supply is to enable bidders to learn what other bidders are doing in each round of the auction and adjust their bidding behavior accordingly before the next round begins. (ComEd Ex. 3.0, pg. 14, ll. 312-314; pg. 32, ll. 689-699; ComEd Ex. 4.0, pg. 29, ll. 677-681; pg. 44, ll. 1027-1031; pg. 59, ll. 1394-1396, pp. 62-63, ll. 1490-1503; ComEd Ex. 8.0, pg. 44, ll. 928-932). The issue for the Commission to decide is whether the "adjustment" in behavior by bidders is a good thing or a bad thing for consumers. That is, does the "adjustment" of bidders' behavior when they are informed of the excess supply remaining in the auction result in a lower price or higher price than if this information was not revealed to the bidders?

According to Dr. LaCasse, information on excess supply will be relevant to a bidder's assessment of other bidders' behavior and the bidder's decision on when to stop bidding. (Joint Tr., pg. 982, ln. 12 through pg. 983, ln. 17). Dr. Laffer agrees that the excess supply information will be key in a bidder's assessment of whether to keep bidding. (BOMA Ex. 1.0, pg. 13, ll. 292-298; pg. 14, ll. 307-328; BOMA Ex. 3.0, pg. 5, ll. 94-104). But unlike Dr. LaCasse, Dr. Laffer concludes that this information will in fact allow bidders to implicitly collude on when to stop bidding and thereby implicitly collude on a high auction price. (BOMA Ex. 1.0, pg. 14, ll. 310-316; ll. 323-328). Dr. Laffer explained this position fully in response to Administrative Law Judge Wallace:

> Q Dr. Laffer --
>
> A Yes, sir.
>
> Q – very briefly, why do you not want information to be shared?
>
> A Because the information --I'm sorry. Excuse me.
>
> Q How are bidders are going to react if they don't have any information?
>
> A Well, they do have a lot of information, sir. It's just that they don't have the information as to what their competitors are doing at this moment.
>
> They know their cost functions. They know the marketplaces. They know the substitution with the PJM markets. They know what the price is. They know all of that. They know the rules.
>
> They just don't know what everyone else is bidding. And that information (*sic*), allowing them to know what everyone else is bidding and at what prices or what volume allows them to game-play the system and effectively have an implicit collusion to keep the price high.
>
> It's like anything -- I guess it was the Duquesne Club dinners, which was the famous antitrust in Pittsburgh where all the suppliers got together and talked price.
>
> That shouldn't be allowed in these markets, sir, because it really allows these people to keep the price higher than it otherwise would be. It's just natural that they would do that.
>
> And I'm not -- I mean, I understand being a supplier and how you always want the highest price, but that's not what's best for the people of Illinois.

(ComEd Tr., pg. 409, ln. 4 to pg. 410, ln. 15).

ComEd's auction designer Dr. LaCasse attempted to justify ComEd's position that bidders should be informed from round to round of the amount of excess supply remaining in the auction by arguing that doing otherwise could subject bidders to the so-called "winner's curse" of over-optimistic bidding (i.e., bidding too low). (ComEd Ex. 19.0, pg. 26, ll. 537-538;

pg. 27, ll. 572-574). This argument is without merit because ComEd's witnesses made it clear that the expected participants in ComEd's auction are not the kind of bidders in need of protection from an alleged "winner's curse."

According to ComEd witness Mr. McNeil, each bidder in ComEd's auction will make an estimation of the value of electricity supply and the risks associated with providing such supply if the bidder is successful in the auction. (ComEd Ex. 3.0, pg. 49, ll. 1060-1069). ComEd witness Dr. LaCasse testified that ComEd's auction places price-risk management responsibility in the hands of competitive entities that are best suited to take, manage, and price these risks, with each supplier free to hedge or meet requirements in any way it chooses. (ComEd Ex. 4.0, pg. 24, ll. 536-544). ComEd's witness Dr. Hogan testified that auction participants would be free to decide how to structure their bids in ways that covered their costs, including profit requirements. (ComEd Ex. 8.0, pg. 39, ll. 821-828).

ComEd's flawed "winner's curse" argument puts it in an incongruous position: Having spared no effort to exalt the expertise and market savvy of its anticipated bidders, ComEd must now portray these same bidders – including financial "players" like Morgan Stanley and Goldman Sachs – as so naive that the Commission must protect them from the excesses of their own optimism. As Dr. Laffer testified, these bidders will know the value of what they are bidding on. (BOMA Ex. 3.0, pp. 13-14, ll. 288-322). Furthermore, to the extent that any bidder is at the risk of being carried away by his or her own excessive optimism it is the bidder, not Illinois consumers, that should bear this risk. After all, one of the objectives of ComEd's auction, specifically expressed by ComEd, is to shift market risks to suppliers and away from both ComEd and its customers. (ComEd Ex. 1.0, pg. 15, ll. 346-347; ComEd Ex. 3.0, pg. 15, ll. 340-342).

In sum, it clearly is not necessary to protect bidders in the ComEd auction from the so-called "winner's curse" by providing them information on the amount of excess supply being bid during the course of the auction. To the contrary, bidders should not be informed of the amount of excess supply remaining during the auction. If the bidders are not provided with this information and the auction is not stopped at a uniform, "market clearing" price as Dr. Laffer has recommended, bidders will make bids closer to their marginal costs of production and thereby lower the supply charges paid by consumers to ComEd. (BOMA Ex. 1.0, pp. 10-11, ll. 1234-1242; pp. 12-13, ll. 272-287; pg. 15, ll. 329-334).

5. Dr. Laffer's Pay as Bid Approach Will Reduce the Opportunity for Bidders to Exercise Market Power

Since bidders will bid closer to their marginal costs of production under Dr. Laffer's approach, it will be more difficult for bidders to exert market power in ComEd's auction. As Commission Staff pointed out in its Post-2006 Report, "the wholesale marketplace, from which ComEd and Ameren will be buying their electricity, is heavily concentrated by a few large generation companies." (ComEd Ex. 1.2, pg. 8). Moreover, as the Staff also stated in the Post 2006 Report, "where concentration levels are high (particularly where one or two firms control a significant portion of production capacity), firms have the ability to exercise market power." (ComEd Ex. 1.2, pp. 8-9).

The record is clear in this proceeding that two companies, Exelon Generation and Midwest Generation, do control a significant amount of electricity production capacity. (CUB-CCSAO Ex 1.2). As Commission Staff witness Dr. Salant testified, Dr. Laffer's pay as bid proposal could reduce the opportunity for bidders to exercise market power in the auction. (Joint

Tr. Pg. 1078, ln. 5-11). This is yet another reason to adopt Dr. Laffer's proposed pay as bid approach rather than ComEd's proposed uniform price method.

6. Pay as Bid Auctions Have Previously Been Used Successfully for Electricity and Other Products

The final reason to adopt Dr. Laffer's pay as bid method is that there are several examples of successful pay as bid auctions for electricity and other products that have already been successfully conducted. Significantly, ComEd auction designer Dr. LaCasse testified that ComEd's proposed auction in this case and the descending clock auction now being used in New Jersey were patterned after the FCC's spectrum auction, which is a pay as bid auction. (ComEd Ex. 4.0, pp. 3-4, ll. 72-86; pg. 11, ll. 235-246). Interestingly, however, ComEd and the New Jersey utilities abandoned the pay as bid format used by the FCC. This decision contrasts dramatically with the recommendation of one of ComEd's witnesses in this proceeding, Andrew Parece, that a pay as bid approach be used by the electric utilities in Massachusetts because pay as bid pricing best accomplishes the goal of determining competitive supply prices. (ComEd Ex. 12.2, pg. 12; see also ComEd Tr., pg. 1197, ll. 13-18). After Mr. Parece's recommendation, a pay as bid competitive bidding approach was utilized in Massachusetts. (Western Mass. Elec. Co., Mass. Dept. Tel. & Energy, Case No. 97-120 (1998), Order, pg.3 and Case No. 97-120-D, Order, pp. 9-10; these orders are attached to this Initial Brief as Attachment D).

Perhaps most significantly, wholesale electricity purchasers with the most experience using auctions to purchase electricity (i.e., utilities in the United Kingdom) used a uniform, "market clearing" price auction beginning in 1990 and then switched to a pay as bid auction in 2001. (BOMA Ex. 1.0, pg. 8, ll. 164-171; pg. 9, ll. 191-194). As Dr. Laffer testified, the regulatory agency overseeing the England and Wales electricity market replaced the uniform approach with the pay as bid method after they found that the uniform price approach facilitated the exercise of market power to maintain or increase electricity prices at the expense of consumers. (BOMA Ex. 1.0, pp. 8-9, ll. 172-188). During the first year of the pay as bid approach in England and Wales, annual prices for baseload electricity decreased by 20% and peaking power prices fell by 27%. (BOMA Ex. 1.0, pg. 9, ll. 191-205). The pay as bid auction format was subsequently implemented in electricity markets across the entire United Kingdom. (BOMA Ex. 3.0, pg. 23, ll. 529-532).

In contrast to the pay as bid auction in the United Kingdom, uniform price auctions in the United States have not resulted in low prices. Ohio and New Jersey are the two states which have conducted descending clock, uniform price auctions to date. In Ohio, the uniform price auction results were rejected because prices were too high. (ComEd Tr. Pg. 516, ll. 2-21; pg. 868, ln. 8 to pg. 869, ln. 16; Finding and Order, Ohio Public Utility Comm. Case No. 04-1371-EL-ATA, pg. 4, paragraph 8 (December 9, 2004); this Finding and Order is attached as Attachment E to this Initial Brief). In New Jersey, achievement of the lowest prices for consumers was not even one of the goals of the New Jersey auction, as ComEd (and New Jersey) auction designer Dr. LaCasse admitted on the record in this proceeding. (Joint Tr., pg. 81, ll. 7-18).

7. ComEd's Uniform Price Approach Violates the Public Utilities Act

In Illinois, apparently unlike New Jersey, achieving the lowest possible prices for consumers not only is a goal, it is the law. The Public Utilities Act ("PUA") requires that public utilities provide service to their customers at the least cost. (220 ILCS 5/8-401). However, ComEd's auction design prohibits bidders from bidding below the "market clearing" price at which ComEd stops its auction. This approach violates the PUA's least cost requirement.

Moreover, ComEd's proposed pass-through of these charges to consumers would violate the PUA's requirement that utility rates be just and reasonable. (220 ILCS 5/9-201).

Unlike ComEd's proposal, Dr. Laffer's pay as bid approach insures that no price would be paid to any supplier in excess of the lowest price at which the supplier was willing to sell electricity to ComEd. (BOMA Ex. 1.0, pg. 11, ll. 256-257). Therefore, the Commission should reject ComEd's descending clock, uniform clearing price approach and instead adopt Dr. Laffer's proposed descending clock, pay as bid recommendation as ComEd's method of acquiring its full requirements for electricity supply beginning January 1, 2007.

I. FIXED PRICE AUCTION PRODUCT AND TARIFFED SERVICES FOR LARGER CUSTOMERS

1. Nature of Auction Product and Tariffed Services for 1 – 3 MW Customers

If an auction process is approved by the Commission, the Commission should require that ComEd's CPP-B auction product be made available to customers with peak demands of 1 to 3 megawatts ("MW") and should reject ComEd's proposal that this class of customers have a separate CPP-A auction product. (BOMA Corr. Ex. 2.0, pg. 6, ln. 130-135). ComEd proposes to make the CPP-B auction product unavailable to customers between 1 and 3 MW (ComEd Ex. 18.0, pg. 25, ll. 556-557) despite the fact that this class of customers, like smaller customer classes, has not been declared competitive. The CPP-B auction product should be made available to the 1-3 MW customer class in order to provide these customers the same price volatility mitigation that ComEd has proposed for other classes of its customers.

ComEd will procure its electric supply requirements for the CPP-B auction product, which ComEd proposes for all customers with less than 400 kilowatts of peak demand, by executing a blend of 1-year, 3-year and 5-year contracts with suppliers. (ComEd Ex. 3.0, pg. 23, ll. 517-519).

In contrast, ComEd will procure its full requirements electric supply for the CPP-A auction only through one-year contracts. (ComEd Ex. 3.0, pg. 26, ll. 551-553).

The 1-, 3- and 5-year contracts that comprise ComEd's CPP-B auction product will be staggered so that after the first year of the auction only 40% of the load will be procured each year. (ComEd Ex. 3.0, pg. 23, ll. 525-529). According to ComEd, the "use of staggered terms [in the CPP-B auction] to keep the procurement percentages in subsequent auctions at 40% facilitates rate stability planning and can mitigate rate volatility for residential and small commercial customers." (ComEd Ex. 3.0, pg. 23, ll. 529-531). ComEd based its proposal to limit the 1-3 MW customer class to the CPP-A auction product on its belief that these customers "have more sophisticated energy planning options available to them, are better able to accept and manage risk, and will have different needs in the post-2006 environment than smaller customers." (ComEd Ex. 3.0, pg. 23, ll. 509-511) Additionally, ComEd witness Mr. McNeil argued in his rebuttal testimony that "providing these customers with such price protection [the CPP-B auction product] may discourage them from seeking out competitive retail suppliers, thereby retarding development of the competitive retail markets." (ComEd Ex. 10.0, pg. 52, ll. 112-126). These arguments do not support the exclusion of 1-3 MW customers from the CPP-B auction product.

Merely because 1-3 MW customers may be more sophisticated than other customers does not mean that they should not continue to be offered ComEd rates that mitigate price volatility. Moreover, although BOMA agrees that the staggered contract terms of the CPP-B auction will somewhat lessen price volatility, ComEd's characterization of the CPP-B auction product as "price protection" that could somehow retard the development of the competitive retail markets is totally inaccurate. While the CPP-B auction product price will be less volatile than the price of ComEd's proposed CPP-A auction product, the CPP-B price is still a far cry from ComEd's currently frozen bundled rates. As BOMA witnesses Messrs. Brookover and Childress stated in their rebuttal testimony:

> It is important to understand that the CPP-B rate does not, by any stretch of the imagination, constitute "price protection." Therefore, it is not our belief that the CPP-B rate would retard competition for the 1-3 MW customer class. The CPP-B rate will change annually, and will therefore be much more volatile than ComEd's currently frozen bundled rates. Even if the CPP rate is extended to 1-3 MW customers, it is reasonable to conclude that 1-3 MW customers will seek out multi-year contracts with competitive electricity suppliers to avoid annual changes in electricity prices.

(BOMA Corr. Ex. 4.0, pg. 17, ln. 376-83).

The record in this case clearly establishes that making the CPP-B auction product available to the 1-3 MW class of customers will not affect the development of the competitive market. Therefore, the Commission should reject ComEd's proposed CPP-A auction product and provide the CPP-B auction product to the 1-3 MW class of customers if an auction process is approved by the Commission.

2. Nature of Auction Product and Tariffed Services for 400 KW – 1 MW Customers

ComEd's original proposal in this proceeding was to make the CPP-B auction product available to the 400 kilowatt – 1 MW customer class. (ComEd 7.0, pg. 9, ll. 195-202; pp. 42-43, ll. 958-972). However, ComEd changed its position in surrebuttal testimony and now proposes that this class also be limited to the CPP-A auction product. (ComEd Ex. 18.0, pg. 25, ll. 558-561). ComEd's new proposal would be detrimental to Illinois customers in the 400 kW – 1 MW customer class for the same reasons it is detrimental to the 1-3 MW customer class. Therefore, the Commission should reject ComEd's new proposal for the 400 kilowatt – 1 MW customer class and instead require that ComEd make the CPP-B auction product available to this class of customers if an auction process is approved by the Commission.

VII. TARIFF AND RATE DESIGN ISSUES

D. ADDITIONAL TARIFF AND RATE DESIGN ISSUES

1. Staff's Rate Increase Mitigation Proposal

Commission Staff witness Peter Lazare has proposed a rate mitigation plan which would "adjust increases in power costs to limit overall bill increases for customers to the greater of the following: 20% or 150% of the average for customers in the CPP-B auction." (ICC Staff Exhibit 6.0, pg. 21, ll. 473-475). If the Commission adopts Mr. Lazare's rate mitigation plan, the Commission should order ComEd to include a separate subgroup for nonresidential space heating customers in their implementation of this plan unless the Commission accepts BOMA's proposal that ComEd exempt nonresidential space heating customers from demand charges in ComEd's delivery service tariffs. (See Section VII.D.3 on page 21 of this Initial Brief).

BOMA witnesses Messrs. Brookover and Childress estimate that nonresidential space heating customers will face rate shock from a rate increase of between 27.2% (at an auction price of 5 cents per kWh) and 46.5% (at an auction price of 6 cents per kWh) in 2007 if no rate mitigation plan is applied to these customers. (BOMA Ex. 2.1). Messrs. Brookover and Childress also showed that the rate increase for nonresidential space heating customers would be 10.7% greater than the increase for nonresidential, non-space heating customers in the absence of rate mitigation. (BOMA Corr. Ex. 4.0, pg. 3, ll. 51-56).

Mr. Lazare testified on cross-examination that it is possible to set up a separate group for nonresidential space heating customers in his rate mitigation plan just as ComEd did when it set up a separate customer transition charge for these customers. (Joint Tr., pg. 1239, ll. 8-19). Mr. Lazare's rate mitigation plan already applies to residential space heating customers because they also are vulnerable to rate shock as a result of ComEd's proposals in this proceeding. (ICC Staff Ex. 14.0, pp. 15-16, ll. 353-358). Clearly, if Mr. Lazare's rate mitigation plan is adopted, the

Commission should order that Mr. Lazare's rate mitigation plan apply to nonresidential space heating customers as well as residential space heating customers.

2. Elimination of Rider ISS

ComEd's Rider Interim Supply Service – ISS tariff ("Rider ISS") has been instrumental in the development of a competitive electricity market during the competitive transition period. (BOMA Corr. Ex. 4.0, pg. 21, ll. 461-462). Nevertheless, ComEd witnesses Messrs. Alongi and Crumrine testified that ComEd does not intend to offer Rider ISS post-2006. (ComEd Ex. 21.0, pg. 44, ll. 1015-1017) As BOMA witnesses Messrs. Brookover and Childress testified: "Rider ISS has been an indispensable part of ComEd's 'toolbox' to encourage customers to make proper electricity supply purchasing decisions." (BOMA Corr. Ex. 4.0, pg. 21, ll. 461- 469). BOMA urges the Commission to request that ComEd continue to offer Rider ISS post-2006.

3. Non-Residential Space Heating Customers

As discussed above, BOMA witnesses Messrs. Brookover and Childress estimate a 27.2% to 46.5% increase in rates for nonresidential space heating customers post-2006 if the Commission does not take action specifically designed to lessen the rate increases for these customers. BOMA proposes that ComEd exempt nonresidential electric space heating customers from demand charges in its delivery services tariffs on electricity used for space heating in order to make the rate increase for nonresidential space heating customers comparable to the increase for nonresidential non-space heating customers. (BOMA Corr. Ex. 4.0, pg. 7, 141-143). This exemption would apply to all non-residential space heating customers regardless of whether they buy their electricity from ComEd or a competitive supplier. This method ensures that there will be no adverse impact on the competitive retail electric market. (ComEd Tr., pg. 756, ln. 14 to pg. 757, ln. 5; Joint Tr., pg. 249, ln. 20 to pg. 250, ln. 7; Joint Tr., pg. 1038, ln. 11 to pg. 1039, ln. 6).

ComEd's current Rider 25 bundled service rate for nonresidential space heating customers, which ComEd's proposals would eliminate, includes an exemption from demand changes for electricity used for space heating. (BOMA Corr. Ex. 2.0, pp. 12-13, ll. 251-259; BOMA Corr. Ex. 4.0, pg. 4, ll.74-75). BOMA's proposal for nonresidential space heating customers merely continues the treatment of these customers that was begun nearly three decades ago when Rider 25 was first instituted. (BOMA Corr. Ex. 4.0, pg. 4, ll. 76-78). Therefore, the Commission should not approve ComEd tariffs in this proceeding unless ComEd first modifies its delivery services tariffs to exempt nonresidential electric space heating customers from demand charges on demand recorded by electric space heat meters in the non-summer months.

VIII. CONCLUSIONS AND MIXED LEGAL/FACTUAL ISSUES

A. LEGALITY OF RIDER CPP

Please see Section V.D.7 on page 16 of this Initial Brief, which discusses the legality of ComEd's proposed descending clock, uniform price auction procurement process that ComEd has proposed in Rider CPP.

B. LEGALITY OF RIDER PPO-MVM

ComEd claims that its proposed Rider PPO – MVM implements the PPO required under Sections 16-110(c) and 16-112(a) of the Public Utilities Act. (220 ILCS 5/16-110(c), 5/16-112(a)). (ComEd Supplemental Statement, pg. 4; ComEd Ex. 17.0, pg. 30, ll. 675-678). In ComEd's proposed Rider PPO-MVM, ComEd uses the electricity supply price determined by the auction process as the tariff's market value. (ComEd Ex. 7.0, pg. 20, ll. 448-451). ComEd's proposed Rider PPO-MVM violates Section 16-112(a) of the Act because this market value is not a function of an exchange or other market traded index, options or future contract or contracts applicable to the market in which the utility sells, and the customers in its service area buy, electric power and energy. (220 ILCS 5/16-112(a)).

The phrase exchange traded or other market traded futures contracts as used in Section 16-112(a) has a plain and obvious meaning, and it is equally plain and obvious that this meaning does not encompass the Supplier Forward Contracts ("SFCs") that will be executed as a result of the auction process as ComEd witness Ms. Juracek has contended in this proceeding. (ComEd Ex. 9.0, pg. 52, ll. 1216-1236). BOMA witness Dr. Laffer testified that a futures contract is an obligation to make delivery or take delivery of a specific quantity of a commodity at a particular price at a specific future date or in a stipulated future month. (BOMA Ex. 1.0, pg. 17, ll. 392-395). Because the Supplier Forward Contracts require the supplier to deliver a tranche, or vertical slice, of ComEd's full requirements for electricity supply they are necessarily indefinite with respect to quantity. (ComEd Ex. 3.0, pg. 21, ll. 460-472; pg. 37, ll. 804-808). Dr. Laffer testified that the indefinite quantity term of the Supplier Forward Contracts would make it impossible to trade these contracts on any exchange or market on which futures contracts are traded. (BOMA Ex. 3.0, pg. 24, ll. 553-556). CES witness Dr. O'Connor and Commission Staff witness Mr. Zuraski agreed with Dr. Laffer that the Supplier Forward Contracts are not futures contracts. (Joint Tr., pg. 246, ln. 20 to pg. 247, ln. 2; pg. 1305, ll. 2-7; Tr., pg. 399, ln. 15 to pg. 400, ln. 10).

In her attempt to argue that ComEd's proposed Rider PPO-MVM does comply with Section 16-112(a), ComEd witness Ms. Juracek also argued that the auction closing price is an exchange traded or market traded index within the meaning of Section 16 – 112(a) of the Public Utilities Act. (ComEd Ex. 9.0, pg. 51, ll. 1212-1213; pg. 54, ll. 1282-1283; pg. 53, ll. 1249-

1254). It strains credulity to believe that the General Assembly, when it used the words exchange traded or market traded index in Section 16-112(a), contemplated a single price determined in a single auction held once per year, yet Mr. Juracek's characterization of the auction price as an index would require such an absurd interpretation of the statute. As Commission Staff witness Mr. Zuraski testified, the price determined by the auction simply is not an exchange traded or other market traded index. (Joint Tr., pg. 1305, ll. 2-7)

In sum, since the Suppliers Forward Contracts resulting from the auction are not exchange traded or other market traded futures contracts and the auction price is not an exchange traded or other market traded index, ComEd's proposed Rider PPO-MVM does not determine its market value in a manner which meets the requirements of Section 16-112(a) of the Public Utilities Act. Therefore, the Commission should find that ComEd's proposed Rider PPO-MVM does not comply with Section 16-112(a) and order ComEd to offer its current Rider PPO-MI or alternatively a PPO determined by a neutral fact finder post-2006 in order to comply with Section 16-112(a) of the PUA.

CONCLUSION

WHEREFORE, for the above-stated reasons the BUILDING OWNERS AND MANAGERS ASSOCIATION OF CHICAGO requests that the Commission:

(a) enter an order adopting Dr. Laffer's pay as bid modification to ComEd's auction procurement process;

(b) enter an order providing that all nonresidential consumers with peak demands equal to or greater than 400 kilowatts and less than 3 megawatts be offered the CPP-B auction product if the Commission approves an auction procurement process;

(c) enter an order requiring that Commission Staff's rate mitigation plan apply to the subgroup of nonresidential space heating customers if the Commission approves Staff's rate mitigation proposal;

(d) enter an order that ComEd's proposed Rider PPO-MVM shall not go into effect on grounds that such proposed tariff does not comply with Section 16-112(a) of the Public Utilities Act;

(e) enter an order requiring ComEd to continue to offer its current Rider PPO-MI or alternatively a PPO determined by a neutral fact finder in order to comply with Section 16-112(a) of the Public Utilities Act;

(f) enter an order requesting that ComEd continue Rider ISS post-2006;

(g) not approve any tariffs for ComEd in this proceeding until ComEd revises its delivery services tariffs to exempt nonresidential space heating customers from demand charges for electricity used for space heating; and

(j) grant such other relief the Commission deems just and proper.

Respectfully submitted,

BUILDING OWNERS AND MANAGERS ASSOCIATION OF CHICAGO

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